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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

Notice of Proposed Rulemaking

JOINT REBUTTAL COMMENTS OF CERTAIN COAL SHIPPERS

Otter Tail Power Company ("OTP"), Public Service Company of Colorado ("PSCo"), Southwestern Public Service Company ("SPS") (PSCo and SPS being operating divisions of Xcel Energy Inc. and doing business as Xcel Energy), TUCO INC. ("TUCO"), Tucson Electric Power Company ("TEP"), and Western Resources, Inc. ("Western") (referred collectively herein as "Joint Commenters"), hereby submit the following Rebuttal Comments in accordance with the schedule set forth in the Board's Notice of Proposed Rulemaking ("NOPR") in this proceeding. These Rebuttal Comments will briefly touch on several key matters highlighted in the reply comments filed by parties in this proceeding on December 18, 2000. Joint Commenters urge the Board to also carefully consider the Joint Comments and Joint Reply Comments they have filed previously in response to the NOPR and in the Advanced Notice of Proposed Rulemaking ("ANPR") stage of this proceeding.

I. When Finalizing the Proposed Rules, the STB Must Recognize That Past Major Mergers Have Diminished Competition and Rail Service Levels

An important underlying (and contested) issue present throughout both the Ex Parte 582 and Ex Parte 582 (Sub - No. 1) proceedings is the extent to which past major rail mergers have resulted in systemic loss of competition and rail service deterioration that must be rectified in future major rail merger proceedings, along with correcting the competitive harm and service deterioration associated with such future mergers. The STB's treatment of this issue has a large bearing on the definition and scope of "enhanced competition" in the final rules. As Joint Commenters have pointed out in their prior filings in the NOPR and ANPR phases of this proceeding, the administrative record in this proceeding is full of testimony and comments from shippers, railroads, and state and federal agencies affirmatively asserting that rail competition and service levels have been systemically reduced as a result of the consolidation of the rail industry over the past decade. As the United States Department of Agriculture ("USDA") cogently observes in its Reply Comments, "[i]ndeed, the problems associated with recent Class I railroad mergers have led us to this very policy debate . . . ." USDA Reply Comments at 3. In other words, the view of these parties and Joint Commenters is that the STB's new policy of "enhancing competition" and improving service must be structured so that the overall state of the railroad industry improves as further consolidation occurs. This improvement must come by adopting measures that increase rail-to-rail competition throughout the industry, not just attempting to offset perceived losses of competition caused by a particular merger.

The STB must not, therefore, proceed from a premise that all is well in the rail industry and that the existing rules need only be changed to prevent harms that might occur in the future. Yet Joint Commenters and others fear that there are strong indications that this might be the STB's approach, both in the STB's decisions in this proceeding and the NOPR's specific provisions. This is clearly the approach the larger Class I railroads would prefer the Board to take, since to do so would effectively "grandfather" the ills of the past that shippers, short line railroads, and others must deal with today, whether or not further consolidation of the industry occurs. As it proceeds toward finalizing the NOPR, the Board must consider the reason this whole policy debate is taking place: that the approval and implementation of major rail mergers in the past decade have resulted in a systemic deterioration of the industry from a competitive and service standpoint. The STB can and must rectify this systemic loss going forward, both in the context of rail mergers and outside of that context. In doing so the "enhancement" of competition cannot be limited to only those instances when specific harm cannot be mitigated, as for example proposed §1180.2 could be read to suggest, and it must emphasize the broad enhancement of rail-to-rail competition, not just competition in the "overall transportation infrastructure."

II. There is No Question That the STB Has Legal Authority to Adopt Specific Measures That Enhance Intramodal Competition

A second important point is that the arguments by Class I railroads that the STB does not have the authority to adopt specific merger rules that enhance intramodal competition have been resoundingly countered in this proceeding and must therefore be rejected. The STB recognized back when it commenced this proceeding that its authority to examine and revise its merger rules stems from the intentionally broad authority granted to the agency by 49 U.S.C. §11324 as well as the National Rail Transportation Policy set forth in 49 U.S.C. §10101:

> The merger provisions of 49 U.S.C. §11324 direct the Board to consider the public interest in general and, in particular, the adequacy of transportation to the public; inclusions of other rail carriers in particular mergers; and financial, employee and competitive issues. The rail transportation policy of 49 U.S.C. §10101, which guides our regulatory activities, directs us, among other things, to promote safety, efficiency, good working conditions, an economically sound and competitive rail transportation system, and the needs of the public and the national defense.

Ex Parte No. 582, *Public Views on Major Rail Consolidations* (March 17, 2000) at 2, note 4, and at 10 ("March 17 Decision"). Numerous parties have affirmed the STB's assessment in their comments in this proceeding. Examples in the Reply phase of this proceeding include: Reply

Comments of NITL at 18-19; PPL Montana Reply Comments at 12-14; EEI Reply Comments at 11-14; and Reply Comments of IMC Global at 2-4. Moreover, Joint Commenters and other parties have demonstrated that ample authority exists elsewhere in the STB's governing statutes for the adoption of specific regulations that will enhance intramodal competition, such as 49 U.S.C. §11102, the actual language of which is much broader and pro-competitive in scope than the ICC's interpretation of it in the infamous *MidTec Paper Corp. v. Chicago and Northwestern Transportation Co.* decision. 3 I.C.C. 2d 171 (1986). Joint Commenters and others urge the Board to overrule the *MidTec* decision and its unreachable threshold requirement of showing anti-competitive conduct, as defined in the decision, before reciprocal switching and use of terminal facilities will be permitted.

In summary, there is ample statutory authority for the Board to adopt specific measures that require the enhancement of intramodal competition as part of the process of considering a major rail merger application.

III. The Board Should Use This Proceeding to Modify the "Bottleneck" Rules

When the Board issued the ANPR, the Board asked whether it was time to modify its rules governing rates over "bottleneck" segments and the so-called "one lump theory" used in past rail merger proceedings to deny relief to captive shippers. The record in this proceeding clearly demonstrates that diverse array of shippers, federal agencies, railroads and others agree that these rules must be modified for the purpose of enhancing rail-to-rail competition. A few examples include: Joint Reply Comments of Certain Coal Shippers at 5; Comments of Subscribing Coal Shippers at 13; DOT Reply Comments at 4 (STB should (1) permit captive shippers with contracts from non-applicant carriers to obtain bottleneck rates without having to go through a competitive access proceeding, and (2) bottleneck access should be the subject of an industry wide rulemaking); and EEI Reply Comments at 14. *See also*, UP Reply Comments at 13 (although Joint Commenters disagree with the specifics of UP's proposal). The Board can and should modify the bottleneck rules along the lines suggested by Joint Commenters, as supported in primary form by many other parties.

IV. The STB Must Strengthen, Not Weaken the NOPR's Provisions Regarding Increased Accountability for Poor Rail Service

The genesis of this proceeding was, in large part the "overwhelming testimony" of large and small shippers, Class I railroad chief executive officers, small railroads, agency heads, Wall Street analysts, Members of Congress, and others of the degree to which rail service in the United States had deteriorated after the last few major rail mergers. *See* March 17 Decision, *supra*, at 4-5. Accordingly, in the ANPR stage of this proceeding, the STB sought "comment on how our merger rules might best be revised to protect customers and shortline railroads from merger-related service disruptions and the loss of adequate infrastructure and capacity." ANPR at 7. The overwhelming response to this invitation was a demand for more accountability and detail on promised merger benefits and post-merger service. Even the major Class I railroads were unanimous in their views that the Board's current policies regarding rail service are inadequate, and that the current policy should be changed to require the submittal of detailed "service assurance plans," although the individual carriers differed on the details of such plans. As this proceeding has progressed, parties other than the Class I railroads have sought to refine and give teeth to the STB's proposals, while the Class I railroads have sought to dilute them. While parties such as DOT have urged requiring service plans with "benchmark measures of service levels that reflect the customers' perspective, as well as benchmarks that measure the railroads' operating performance," including transit and cycle times, DOT Reply Comments at 5, the Class I railroads plead for "flexibility" and deference to railroad "know-how."

In addition to divergent views over the content and meaning of service assurance plans, there is a clear dispute between the Class I railroads and shippers and other parties over whether the Board should promulgate regulations that contain enforceable monetary penalties for rail service failures, and implement accompanying dispute resolution procedures, such as arbitration. Shippers and many others want them, the Class I railroads and a few others do not.

In promulgating final rules that are designed to prevent the deterioration of rail service, the STB <u>must</u> recognize that a primary goal of this entire proceeding: improvement of rail service now and into the future, will <u>only</u> be realized if rail-to-rail competition is improved <u>and</u> specific, meaningful regulatory "hammers" are in place that provide the major railroads with incentives to improve rail service or continue good rail service. The Class I railroads' concerted attempt to emasculate both the reporting of service related information and the availability of meaningful relief in the event of service failures must be rejected. As the STB moves forward with finalizing the NOPR, the following positions asserted by the Class I railroads in this proceeding must be viewed circumspectly in light of past mergers, the realities of railroad market power, and the state of the railroad industry:

1. "Service Assurance Plans have to be 'flexible'"

The ability to adjust service assurance plans after a merger is approved is not *per se* objectionable; indeed it might be necessary to achieve the desired policy goal. However, the STB must limit the flexibility of service assurance plans to that which is truly required for the carriers to respond and correct service problems. Moreover, flexibility (and deference to railroad know-how) cannot be allowed at the expense of achieving policy objectives. DOT speaks for many when it states at "[t]he burden should be on applicants to develop service plans that are sufficiently robust to accommodate normal changes in the business cycle without permitting service levels to fall below pre-merger standards." DOT Reply Comments at 6. *See also* PPL Montana Reply Comments at 18-19.

2. "Railroads already have 'powerful economic incentives to avoid service problems,' because the costs of such problems fall on the railroads."

This, of course, is an exaggeration. For example, the STB recently determined that the costs of even the most severe post-merger railroad service crisis in history can be indirectly passed on to railroad customers by permitting such costs to be included in the calculation of the merged railroad's variable costs. STB Finance Docket No. 33726, *Western Coal Traffic League vs. Union Pacific Railroad Company* (Decision served November 30, 2000). Such inclusion, combined with the fact that the STB only has jurisdiction to assess the reasonableness of rates that are greater than 180% of variable costs, allows a merged railroad to increase rates to recover service related costs immune from STB scrutiny. Moreover, current STB policy permits a merged railroad to raise rates immediately after a merger, even when a so-called "merger premium" is paid, thereby further shifting the risk of service failures from the railroad to its customers. See EEI Reply Comments at 12.

3. "Shippers can always negotiate service guarantees"

This is simply untrue for the majority of rail shippers, particularly captive rail shippers. The Board should take note that virtually no rail shipper or other non-railroad party has agreed that private negotiation is a viable means to obtain service guarantees for more than that select class of shippers who are blessed with rail-to-rail competition from origin to destination. As Joint Commenters have stated from the beginning of this proceeding, improved rail <u>service</u> will only come from the creation of meaningful rail <u>competition</u>. Joint Comments of Certain Coal Shippers (ANPR) at 1. *See also*, Reply Comments of American Chemistry Council and the American Plastics Council at 3-4. Presently, the absence of meaningful competition in much of the railroad industry means the inability to negotiate meaningful service guarantees. *See, e.g.* PPL Montana Reply Comments at 20-21. Even DOT, which encourages privately negotiated service guarantees, recognizes that merger applicants need to have incentives to offer such guarantees, and that; presently, "service guarantees present a 'difficult challenge.'" DOT Reply Comments at 6. Incentives to provide meaningful service guarantees must either come from real competitive pressure or from the Board, and it is clear that the current regulations governing remedies for service failures are inadequate, since they permit a certain level of service deterioration after a rail merger.[1] *See* Joint Comments of Certain Coal Shippers (ANPR) at 11-13; Joint Comments of Certain Coal Shippers (NOPR) at 15-18; EEI Reply Comments at 11.

In conclusion on this point, this proceeding was the result of nationwide disgust with railroad service, which had deteriorated to the point of costing the Nation's economy billions of dollars in lost revenues, increased operating costs, and wasted product. The enhancement of rail-to-rail competition and improved rail service go hand-in-hand, and the STB was wise to combine the two policies into this one rulemaking. However, the proposed rules regarding preservation and improvement of rail service after a rail merger must be strengthened to achieve the desired policy goal, not weakened as the Class I railroads would prefer.

V. Rejection of Railroad Procedural Recommendations

Other utility parties have demonstrated in their reply comments the fallacy of the proposals by BNSF to substantially shorten the time period for processing a major rail merger application. EEI Reply Comments at 5-8; PPL Montana Reply Comments at 6-7; IMPACT

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[1] In its Reply Comments, UP states that it is "the only party to offer a concrete proposal for service remedies." UP Reply Comments at 11. Whether UP in fact holds this distinguished honor is highly disputable. In any event, Joint Commenters have shown that UP's proposal is a nonstarter because it permits service levels to deteriorate to below 50% of pre-merger levels for more than 60 consecutive days before any relief can be obtained, then gives the consolidated railroad another 60 days to "cure" its service problems by <u>merely returning service to the 50% level</u> and keeping at that reduced level. UP Initial Comments, Appendix A at 9.

Reply Comments at 40-41. In particular, EEI demonstrates that BNSF's attempted comparison with the merger policies of the Federal Energy Regulatory Commission ("FERC") is flawed because FERC's ability to process utility mergers somewhat faster than the STB's pace of processing rail mergers is due in large part to the fact that FERC <u>already has in place important measures that require merging applicants to enhance competition and keep rates from increasing after the merger</u>. *See* EEI Reply Comments at 6. These measures include open transmission access requirements and rate freezes. The existence of clearly defined, tested rules and guidelines regarding the enhancement of competition in the FERC merger policy means that merger applicants include these measures in their applications, and there are thus fewer questions about whether the public interest has been served. This is a far cry from the present situation at the STB, and Joint Commenters do not see the STB having the same ability as FERC to more quickly process major merger applications unless the policy to "enhance competition" is set out much more clearly and distinctly in the final rules, and they clearly establish pro-competitive measures on a par with those known to parties seeking merger approval from FERC.

Respectfully submitted,

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January 11, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have served on this 11th day of January, 2001 a copy of the above JOINT REBUTTAL COMMENTS OF CERTAIN COAL SHIPPERS by first class mail postage pre-paid, to all parties of record.

Aimee DePew